# Fiduciary Commentary

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**Brant Griffin QKA, AIFA®**
Partner

w 800 403 7065 x211
e brant.griffin@npier.com
www.npier.com

## Effective Financial Education: Why Financial Wellness Matters

A decade after the great recession, the financial crisis still lingers on for countless Americans. Many households are unable to get from under the heavy burden of consumer debt. Research from the New York Federal Reserve Bank shows that the household debt surpassed $13 trillion at the end of 2017, exceeding the $12.7 trillion of toxic mortgage-related debt from 2008. Unlike ten years ago, today's indebtedness is broader and arguably affects a larger spectrum of consumers including the tab from student loans, auto financing and credit cards.

This heavy consumer red-ink results in financial stress that can permeate its way into the workforce and cause employee productivity loss. To alleviate financial ills, employers have traditionally provided financial education to inspire savings and investment and to encourage prudent financial decisions. At its face, this appears to be a reasonable response to combating economic anxiety and helping employees budget their wages, build confidence and save for the future. However, studies have shown that the years of plying away at providing investment education has been ineffective. A growing percentage of American workers have saved shockingly little for retirement. Some estimates show 50% of the American workforce live paycheck-to-paycheck and 42% have not set aside any retirement savings at all. In fact, 19% of individuals have no savings to even cover emergency expenses. Many among us still remain unaware about basic economic concepts and have yet to embark on saving for retirement.

Financial education is traditionally a one-size-fits-all approach designed to alter spending habits and encourage saving and investment. This method cannot be fully effective to support the broad spectrum of savers with unique characteristics and needs. The efficacy of this approach, typically provided as a classroom-like lecture with written materials, is often based on ideology rather than results.

Information and education alone is unlikely to have a lasting effect on employee behavior and altering engrained behavior patterns. Although financial literacy has good intentions, it is not always the solution to yield the best results due to the challenge of incorporating what is learned into practice. Richard Thaler, a prominent behavioral economist, has said that true financial literacy is nearly impossible especially when making a crucial financial decision. It is extremely confusing to know the right road to take, even for an economist.

### Behavioral Economics and Its Effect on an Individual's Decision-Making

Traditional economics adopts the theory that people are rational when making decisions to achieve their own self-interest. Conversely, the study of behavioral economics has demonstrated how a multitude of factors influence our behavior and how individuals do not always act in a manner that supports their own well-being. Behavioral economics views that decision making is largely connected with sociology, psychology and other areas of science. This field of study has demonstrated how cognitive factors have an intense influence on our decisions relating to money and financial activities.

It's undeniable that behavior is difficult to change. A notable study of participants with low to moderate income showed that their primary desire is for financial security. The participants were able to identify several key actions needed to achieve the objective, yet a year afterwards nearly none of them had initiated any of the actions needed. Social scientists have classified this scenario as the *Intention/Action gap* (the difference between what people plan to do, and what they actually do).

Behavioral economics explains that people are influenced by cognitive biases which are deeply entrenched in our psyche. These biases lead to impulsive consumer decisions controlled by cognitive limitations and the urgency to choose. Some of the more common cognitive biases include:

- *Discounting the future:* Choosing immediate gratification above longer-term objectives. The present is tangible, immediate and satisfies our current needs. The here and now will often weigh more heavily than future needs. Discounting the future results in overspending by discounting the future costs associated with such activity.
- *Overconfidence:* Underestimating the possibilities of future misfortune while remaining overly optimistic concerning present circumstances. An example would be those that believe that an accident is unlikely to happen and therefore do not buy insurance.
- *Anchoring* is when one tends to use an initial piece of information as a reference point to make a subsequent decision, no matter how illogical it may be. This can result in overspending due to how pricing is presented to us.
- *Confirmatory bias:* The tendency to cherry-pick information and weigh more heavily the information to justify one's own belief, while downplaying information that contradicts one's opinion. This tendency lends to irrational and stubborn behaviors.
- *Loss aversion:* The phenomena describes the tendency of a consumer to fear losses over the equivalent gains. It explains that fear and anxiety is more powerful than positive emotions.

These powerful predispositions are difficult to overcome as they are rooted in our most primal instincts. These tendencies help explain the challenge of traditional education efforts and why alternatives have been sought to overcome our instinctual patterns that produce poor financial decision making.

## Financial Wellness

The field of financial wellness utilizes various tools to combat our lingering biases and change consumer behavior. Financial wellness utilizes various strategies to strike a balance of the psychological and tangible facets of our views towards finances. In other words, financial wellness aims to provide a comprehension of your current situation, develop a plan to achieve personal and financial goals and manage the adversities that will inevitably arise along the way.

Although financial wellness is still a relatively new area of practice, its effectiveness in promoting productive behavior has already been widely recognized. Some of the key principles for successful financial education that will help employees make sound financial decisions for their future include:

- Know your audience. Acknowledge that situations vary, and information should be personalized to match one's specific status, challenges and goals.
- Deliver actionable, relevant and timely information. Develop a suitable plan related to a specific goal to combat our cognitive tendency to bias the present.
- Advance broad skill sets. Teach how to find relevant information and how to process that information to make an informed decision from what is learned.
- Build motivation. Supporting individuals to identify their own values, to maintain persistence in the inevitable challenges they will face and to stay enthusiastic about their future.
- Create habits that support good decisions. Help individuals form new healthy habits that will reinforce positive outcomes.

Employers can play a vital role in their employee's financial well-being by assisting savers in managing their employees' overall financial health. Financial wellness programs are growing rapidly as companies continue to realize the importance in addressing the financial challenges of its workforce.

In financial wellness sessions, a practitioner collaborates with the employee to work towards financial objectives through one-on-one interaction either by phone, video conference or in-person. The programs encourage savers to take control of their own finances with the support they need to be successful. Assisting employees to identify financial priorities, setting goals with a realistic timeline and applying the principles of financial education are critical aspects of an effective program. Programs will frequently offer a tailored assessment of an employee's income in retirement based on their individual wages. They also frequently provide information regarding other employee benefits beyond the company retirement plan to provide a comprehensive picture of the employer's benefits package.

### Summary

It is undeniable that behavior is difficult to change especially when financial matters are involved. There is no one perfect way to help employees save for retirement as the unique needs of a workforce will respond differently to various communication strategies. Clearly, it is critical to any education effort to identify and address the destructive human predispositions regarding spending and other financial decisions. There are a wide range of approaches to effective education and the use of financial wellness concepts are imperative to successfully help savers bridge the gap between their financial intentions and actions and to achieve what many believe to be an elusive dream—financial security.